Reviews - Writings in Accounting

Marie E. Dubke

REVIEWS

Writings in Accounting

DR. MARIE E. DUBKE, CPA, Editor
Memphis State University
Memphis, Tennessee

"THE MISSING LINK IN SUPERVISION OF THE SECURITIES MARKET," R. J. Chambers, ABACUS, Vol. 5, No. 1, Sept. 1969.

In this most recent addition to a lengthy list of publications, Professor Chambers continues his verbose but enjoyable campaign to revitalize financial accounting. From a study of take-over bids of seventeen Australian firms (see ABACUS, September 1965), Chambers produced empirical evidence that the shareholders were not properly informed in these instances. As one could expect from his past writings, Chambers contended that more rational decisions could have been made by the shareholders had they been provided with financial statements (of which the balance sheet is an equal partner) based on a current cost basis.

As the title suggests, this article builds a case for the assertion that the regulations governing the securities markets in the United States and the United Kingdom are inadequate to prevent "uninformed or misinformed action on the parts of buyers and sellers" of interests in corporate equities. The inadequacies exist not so much because of what is required, but because of what is not required. The case is built upon a logical, common sense analysis of the purpose of security markets and their regulation by society and upon the informational needs and potential conflicts of interest among the various groups operating in the securities market.

The securities market serves two functions—allocative and redistributive. For the market to operate in a socially acceptable manner, all parties involved must be equally well informed. In the U. S. the Securities Act of 1933 specified the use of original cost in balance sheets. This was a reaction against assumed (but not supported by the facts) revaluation abuses in the immediately preceding years. The prescribed adherence to cost produces statements inconsistent with real business results and positions thereby producing anomalie. Cost is side-stepped in the balance sheet presentation of inventories at lifo, through the "creative book-keeping" procedure of increasing earnings per share by slowing down the depreciation rate, and by improper tax allocation and lease capitalization.

Legislation in the U. K. has never barred asset revaluation; such practice is optional, which does not enhance intercompany comparisons. Examples are given of the resultant anomalies created by this form of legislation.

The legislation governing the securities markets in the U. S. and the U. K. has as its goal "fair representation in the interests of investors, creditors and a fair market." The remoteness of investors appears to have been overlooked as well as "the allocative function of the market and the pertinence to it of up to date information." As long as managers can pick and choose the accounting methods to be used, shareholders and society are not protected from misallocation of resources.

The missing link in the protection of shareholders is the absence of the requirement that all assets be shown at current resale value. This "is the one piece of information which pins all expectations and opinions to the facts of the market place, where buyers and sellers, issuers and brokers, borrowers and lenders make their play and their profits and losses. It is linked to every interest and is essential to the informed judgment of every party of interest."

A brief review can not capture the pleasing literary style of Professor Chambers (which more accounting authors would do well to emulate) nor the neatness of his analysis. Everyone interested in the future of accounting should read Chambers.

Dr. Marilynn G. Winborne, CPA
The University of Arizona

"DOCUMENTATION STANDARDS," Max Gray and Keith R. London; Brandon/Systems Press Inc., Princeton, New York, 1969; 171 pages.

Our accounting profession has taken tremendous strides in the past few years in an attempt to utilize data processing equipment. This utilization has been concerned with the traditional responsibilities of the accountant as well as the new responsibilities of providing information for planning and decision-making. This addition to the scope of the accounting function, along with an increasing growth in the complexity of our society, has increased the importance of documentation in the information system.

In recent years accountants have had references for documentation of traditional accounting systems but not for data processing systems. "DOCUMENTATION STANDARDS" pertains to data processing systems and is a good reference for this phase of the accounting function.

As stated by the authors, the primary objectives of this book are:

1. to define the purposes and types of documentation and to assign responsibilities for preparatory review and approval of documentation—
2. to describe the roles and content of documentation within systems development—
3. to show the importance of documentation in project control—
4. to emphasize the importance of documentation standards and to outline methods of developing these standards—
5. to outline a model documentation system.

Chapters 1 and 2 contain a discussion of the "Background to Data Processing Documentation" and "Documentation in a Working Environment." A distinction is made here between development documentation, which describes the system, and control documentation, which contains information about project development organization, personnel, time, materials, and money. Thus, documentation is discussed from a "purpose" point of view and the environmental considerations in that "purpose."

Chapters 3—7 contain discussions of the various components of development documentation. These components are described as "Analytical Documentation," "System Documentation," "Program Documentation," "Operations Documentation," and "User and Management Aids."

Control of documentation is then discussed, which includes project control descriptions, the documentation library, and maintenance and the development of documentation standards.

It seems to this writer that control documentation should be considered before descriptive documentation, but it is realized that in practice both types are designed and prepared somewhat simultaneously.

This book is technical in that it contains examples of various documents, but it is written on a level that anyone can understand. It is not a "textbook type" book but is a reference book and contains many ideas and examples which would serve to help strengthen the documentation in any system. Anyone interested in data processing or systems would consider her time well-spent in referring to this book.

Dr. Dora Herring, CPA
Mississippi State University

"ACCOUNTING FOR INFLATION—A FIELD TEST," Paul Rosenfield, JOURNAL OF ACCOUNTANCY, June 1969, Volume 127, Number 6.

In 1961, the Accounting Principles Board started a program to determine "appropriate accounting under conditions of inflation." This article deals with the results of price level adjusted statements prepared by 18 United States companies for two different years.

The author first discusses the objectives of general price level financial statements. He explains that they show "changes in the general level of prices . . . (not) changes in specific prices of goods and services." He discusses the gains and losses resulting from holding monetary items such as cash, receivables, and payables during inflation.

The article then tabulates five items for each of the 18 companies. (The companies are identified only by alphabetic letter.) These are net income, general price level gains and losses, federal income taxes, cash dividends, and rate of return on ownership.

The results of the study indicate that inflation does not affect all financial statements in the same way. Some companies showed increased net income while others showed decreased net income. There was also a "ballooning" effect on the statements. During the 15-year period, 1953-1967, inflation averaged 2% per year. While the highest rate of inflation during the period was 3.7%, the effect on net income was much more severe. This is partly because net income is a small amount compared to other amounts on the financial statements. Secondly, restatement of items such as depreciation brings a cumulative compound effect on the statements.

Restated income of the 18 companies for the two years in the study ranged from an increase of 434% of historical income to a decrease of 31%. Gains and losses from holding monetary assets also varied widely.

The effective income tax rate varied in both directions. In some cases the restated rate was lower than the historical rate; however, in most cases the restated rate was higher than the historical rate. Cash dividends as a percent of net income acted in like fashion. In some cases the restated rate was lower than the historical rate; in twice as many cases it was lower.

The rate of return on owners' equity was not available for all firms. In those cases where it was available, in every instance the rate of return using restated figures was lower than the rate of return based on historical figures.

The author points out certain observations concerning the study. The companies which are most affected by the restatement process are:

1. Capital intensive companies,
2. Companies with expensive and slow-moving inventories,
3. Companies which are either heavy debtors or heavy creditors.

In connection with the third point, those companies which have large receivables lose because of general price level changes in inflation and companies with heavy debt gain. Of course, a company which is able to offset heavy receivables with heavy debt will offset gains and losses.

The most interesting statement in the article is that the companies involved reported that proper preparation in advance would have solved many practical problems which were encountered in the study. Also, restatement in the first year is most time-consuming because in subsequent years analyses prepared previously can be utilized. The participants in general agreed that with proper preparation practical problems should not present a significant barrier to preparation of general price level financial statements.

Thus, since it is clear that supplementary, price-level-adjusted financial statements offer useful information to those both inside and outside the firm, this reviewer believes we shall certainly see more of them in the future.

M.E.D.

"ACCOUNTING AND AUDITING FOR REGULATED INVESTMENT COMPANIES," Frank H. Tiedemann, CPA, THE JOURNAL OF ACCOUNTANCY, Volume 129, Number 1, January 1970.

In a clear, concise, and well organized manner, Mr. Frank H. Tiedemann, CPA, presents the fundamental aspects of accounting for regulated investment companies and, in particular, for the popular mutual fund.

The discussion, narrowed to manageable proportions, introduces the various types of investment companies, explains the applicable financial accounting and reporting requirements, and includes the germane income tax provisions. His coverage of the important compliance reporting to the SEC provides insight into the extent of government regulation of the required accounting and reporting practices. Drawing heavily from his extensive practical background in this specific accounting area, the author includes helpful information on the planning of special and supplementary audit procedures and on the writing of pertinent accountants' reports.

This article, as introductory reference material, is worthwhile reading for the accountant who is not involved in this accounting province. For those who are, it should serve as a quick reminder on important points and provide a framework upon which to build a course of concentrated study.

Katherine M. West, CPA
Brooklyn College of The
City University of New York

THE TAX ADVISOR

Beginning January 1970, a new magazine appeared on accounting book shelves and desks. Published by the American Institute of CPAs, the announced purpose of the monthly publication is to keep the reader "reliably informed on federal tax matters." Written for the "sophisticated tax man" it will feature articles to give "greater insight into current problems" in an accurate, concise, and practical way. The "Tax Clinic," formerly found in THE JOURNAL OF ACCOUNTANCY, will be a regular feature, as will Tax Trends, Tax Practice Management, Estate Planning Techniques, Working With the IRS, and Washington Report. The charter issue contains a special supplement, a checklist-summary of the 1969 Tax Reform Act, prepared by the Chairman of the Executive Committee of AICPA's Division of Federal Taxation, William T. Barnes.

One of the special features of the new magazine is that three references (to the official reporters, Commerce Clearing House, and Prentice Hall) will be provided for all decisions except those of the Tax Court. The 64-page magazine will also contain a selection of each month's rulings and cases, together with comments from the editor as to whether "(1) a conclusion, ruling or decision is questionable, (2) tax planning opportunities are available, and (3) there are limitations or wider implications to a holding." (THE CPA, December 1969). Subscription price to non-members of AICPA is $25 per year.

M.E.D.